

AR57

Expanding the Market

1996 Annual Report

D R A X I S H e a l t h I n c .



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Stock Symbols

DRAKIS Health Inc.
TSE: DAX
NASDAQ: DRAXF

Corporate Overview

DRAKIS Health Inc. is an emerging Canadian-based pharmaceutical company with four operating divisions – Veterinary, Dermatology, Canadian Pharmaceutical Marketing and, recently announced, Radiopharmaceuticals.

Veterinary Pharmaceutical Operations

Veterinary operations are based on the Company's worldwide proprietary rights to Anipryl®, a unique formulation of l-selegiline used in the treatment of canine Cushing's disease and canine cognitive disorder. Anipryl is approved and is being marketed for both indications in Canada. In February 1997, the Food and Drug Administration (FDA) indicated that the efficacy section of the Anipryl file is complete and supports the claim that Anipryl is effective for the treatment of the Cushing's indication.

Dermatology Pharmaceutical Operations

Dermatology operations span North America with four prescription and fifteen non-prescription products in Canada and one prescription and two non-prescription products in the US. DRAKIS operates its own research and formulation development facility in St. Laurent, Québec.

Canadian Pharmaceutical Marketing Operations

Canadian Pharmaceutical operations market, develop and sell prescription pharmaceutical agents. The primary current focus is on prescription pharmaceuticals for Parkinson's disease where, with four prescription products, it continues to have significant market share. Its pipeline now includes agents for the treatment of Parkinson's disease, narcolepsy, Alzheimer's disease, cancer and metabolic bone disease.

Radio-pharmaceutical Operations

In April 1997, DRAKIS entered into a letter of intent with Merck Frosst Canada Inc. to acquire its Radiopharmaceutical division and its advanced pipeline of radiopharmaceutical products.

Financial Performance and Outlook

1996 was a transitional year in which DRAKIS restructured and refocused its operations. The financial results for the year reflected the major changes which impacted on the Company including the generization of Eldepryl®, divestitures of non-core investments and the continued diversification of the Company's earnings base through acquisition and product launches.

With its strong financial position, focused business strategy and promising product opportunities, DRAKIS is now well positioned for growth in 1997 and beyond.

(in millions of Canadian dollars except share related data)

	1996	1995	1994
Revenues	\$ 15.6	\$ 16.6	\$ 17.1
Earnings (loss) before interest, taxes, depreciation and amortization	(5.2)	0.7	5.0
Net income (loss)	(0.2)	2.4	1.1
Cash and cash equivalents	\$ 25.8	\$ 16.6	\$ 11.7
Common shares outstanding	29,263,602	20,126,718	20,019,297

1996 Highlights

January

- Acquisition of the exclusive rights to distribute Anipryl in Canada

February

- Release of statistically significant results of its one-year double-blind, randomized, placebo-controlled clinical study of Modafinil, a drug for the treatment of narcolepsy, a chronic sleep disorder
- Release of statistically significant results for LipoTECA™ and commencement of a second and larger ongoing clinical trial

March

- Appointment of Mr. Brian M. King as Chairman of the Board
- Sale of remaining interest in DUSA Pharmaceuticals, Inc. while retaining the Canadian rights to Levulan™ Photodynamic Therapy

April

- Launch of Anipryl in Canada for canine Cushing's disease

May

- Raised \$12.75 million gross through the sale of 3.0 million special warrants

June

- Health Protection Branch (HPB) submission for Anipryl for the treatment of canine cognitive disorder

July

- Acquisition of Tican Pharmaceuticals Ltd., a Canadian company with expanding US operations

August

- Merger of IHS and Stēf International, with DRAXIS retaining a 30% interest in the combined company
- HPB submission for Modafinil for the treatment of narcolepsy

September

- Appointment of Mr. Jim A. H. Garner, Vice President Finance and Chief Financial Officer

October

- Receipt of HPB approval for two additional dosage forms of Anipryl (bringing the list to five) and for distribution of Anipryl in a specially-designed blister pack
- Launch of Essential SPa program, a line of skin care products

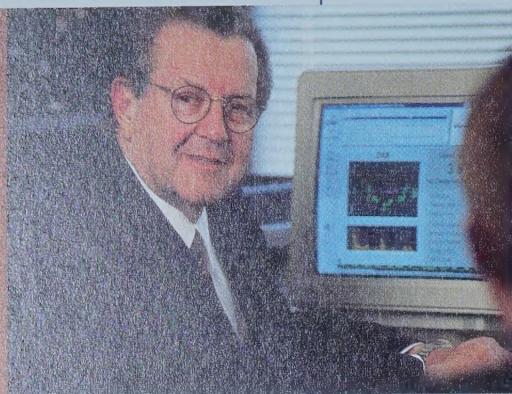
November

- Acquisition of the remaining shares of its development-stage affiliate, DAHI

1997 first quarter events

- DRAXIS acquires Canadian rights to Mylan's paclitaxel (taxol)
- FDA accepts efficacy claim for Anipryl for canine Cushing's disease
- HPB approves Anipryl for canine cognitive dysfunction
- DRAXIS Health acquires SpectroPharm
- Canadian Intellectual Property Office issues use patent for Anipryl
- DRAXIS Dermatology Division to promote Zonalon®
- European Patent Office grants patent for Anipryl
- DRAXIS announces letter of intent with Merck Frosst Canada Inc. to acquire its radiopharmaceutical division and its related product pipeline

President's Letter to Shareholders



Martin Barkin, MD, BScMed,
MA, FRCSC
President and CEO

In the past year, DRAXIS has crystallized its core strategy for growth. We have committed our resources to concentrate on specialized niche areas where we can leverage our unique assets to bring needed pharmaceutical agents to the marketplace. These allow us to partner with, rather than compete against, larger multinational companies. To help achieve our goals we have organized into three pharmaceutical business units: Veterinary, Dermatology, and Canadian Pharmaceuticals. Each one is poised for a revenue breakout in 1997 as a result of pending new product launches, acquisitions, and expansion into new geographic territories – particularly the US.

The Veterinary unit now markets and sells Anipryl in Canada for both canine Cushing's disease and canine cognitive disorder. It is poised to launch Anipryl into the 10 times larger US market for canine Cushing's disease once final FDA approval has been received. Efficacy review of the Anipryl file was completed in February 1997.

Dermatology, with the recent acquisitions of SpectroPharm and the Canadian marketing rights to Zonalon, now has four prescription products and fifteen physician-recommended OTC products in Canada including the leading product in its category – SpectroJel®. SpectroJel will be introduced into the US under the name SpectroDerm® in Q2 1997, bringing to three the dermatology products marketed and sold in the US.

Canadian pharmaceutical marketing holds a leading position in the Canadian neurology marketplace. It is awaiting regulatory approval of Modafinil for narcolepsy which it expects to introduce in Q4 1997. It also recently acquired the Canadian rights to Mylan's paclitaxel (taxol) for Canada which it plans to launch in 1999. These add to its pipeline of in-licensed drugs for cancer, osteoporosis, metabolic bone disease, and Alzheimer's disease.

Over the past two and a half years we have been rebuilding our business on new platforms. We have now established three operating units, each poised to expand its market with new products and in new territories. In April 1997, we entered into a letter of intent with Merck Frosst Canada Inc. to acquire what will become our fourth operating unit – Radiopharmaceuticals. This unit brings with it a rich pipeline of pharmaceutical agents and an international marketplace.

With the many new product launches expected to take place in 1997, we look forward to significant revenue growth starting in the second half of 1997 and continuing through to the year 2000 and beyond. We thank our customers, shareholders, board of directors, employees, corporate partners, sales associates, and distributors.

Sincerely,

A handwritten signature in black ink that reads "Martin Barkin MD". The signature is fluid and cursive, with "Martin" and "Barkin" connected by a single stroke, and "MD" written separately at the end.

Dr. Martin Barkin
April 22, 1997

From left to right:

Jim Garner, Vice President Finance and Chief Financial Officer

Martin Barkin, MD, BScMed, MA, FRCSC, President and CEO

Roger Mailhot, PhD, Pharmacologist, Vice President, Scientific and Regulatory Affairs

Jacqueline H. R. Le Saux, MBA, LL.B, Vice President, Corporate Development,

Business Unit Leader: Canadian Pharmaceutical Marketing Operations

Bernard J. Marzalik, Vice President, Marketing and Sales,

Business Unit Leader: Dermatology Operations



E x p a n d i n g t h e M a r k e t

An increasing presence

Through its three operating divisions, DRAXIS is now poised to launch new prescription and OTC products both in Canada and the United States. The North American potential for Anipryl is estimated at between \$50 million and \$100 million. SpectroJel, now doing more than \$3 million a year in Canada, is about to be launched into the US marketplace. Modafinil is poised for its launch in Canada by the end of 1997, paclitaxel by the end of 1998.

Substantial cash reserve

In 1996, the Company raised net proceeds of \$11.6 million in the equity market and realized \$9.3 million from the divestiture of its spin-off company, DUSA Pharmaceuticals, Inc., while retaining Canadian rights to all Levulan Photodynamic Therapy products. Thus, despite the investment in several major product launches, including Kerasal®, Anipryl and Tican's dermatology products, and the expense of the profit sharing generic agreement with Novopharm, the cash reserves of the Company reached \$26 million at 1996 year end. The Company will continue to use its strong cash reserves to actively pursue its strategy of acquisitions of companies, technologies, products and distribution rights to drive the growth of its marketing, sales and distribution operations in Canada and the US.

Experienced senior management

DRAXIS is led by a strong senior management team headed by Dr. Martin Barkin, President and Chief Executive Officer. Dr. Barkin was a former Canadian Deputy Minister of Health for the province of Ontario (1987-1991) and a former partner in charge of the health-care practice in Canada for a Big Six CPA firm. Other members of senior management have held key positions at Ciba-Geigy, Dupont, Syntex and Abbott. In September 1996, Jim Garner, with a background in investment banking, joined DRAXIS as Vice President Finance and Chief Financial Officer.

Veterinary Pharmaceutical Operations



From left to right:

Daniel E. Walker, Director, Manufacturing and International Regulatory Affairs

David R. Stevens, President and Chief Executive Officer

Michael R. Grogan, Director, Marketing and Sales

Laura D. Sayler, Director, Finance and Administration

William W. Ruehl, VMD, Vice President of Scientific Affairs

Worldwide rights to Anipryl

DRAXIS, through its wholly-owned subsidiary, Deprenyl Animal Health, Inc., has worldwide intellectual property rights to Anipryl. With the US launch imminent, DRAXIS is firmly placed in the growing market of companion animals. The two major indications for this prescription veterinary pharmaceutical are for the treatment of canine Cushing's disease and canine cognitive dysfunction, both age-related, neurological degenerative diseases.

Canine Cushing's disease

Canine Cushing's disease is a widespread chronic endocrine disease of dogs that is estimated to affect 160,000 pet dogs each year in North America. The successful use of Anipryl for this disease results in a better quality of life and reversal of both the signs and symptoms of the disease.

FDA approval

Already approved in Canada for the treatment of canine Cushing's disease and canine cognitive disorder, DAHI also filed with the FDA for approval to market Anipryl for canine Cushing's in the US. In February 1997, the FDA approved the efficacy section of the Anipryl application for the treatment for canine Cushing's disease. There only remains inspection of the manufacturing facility, labeling and Freedom of Information summary before Anipryl can be approved for marketing in the US. The Company expects to launch the product in the US in mid-1997.

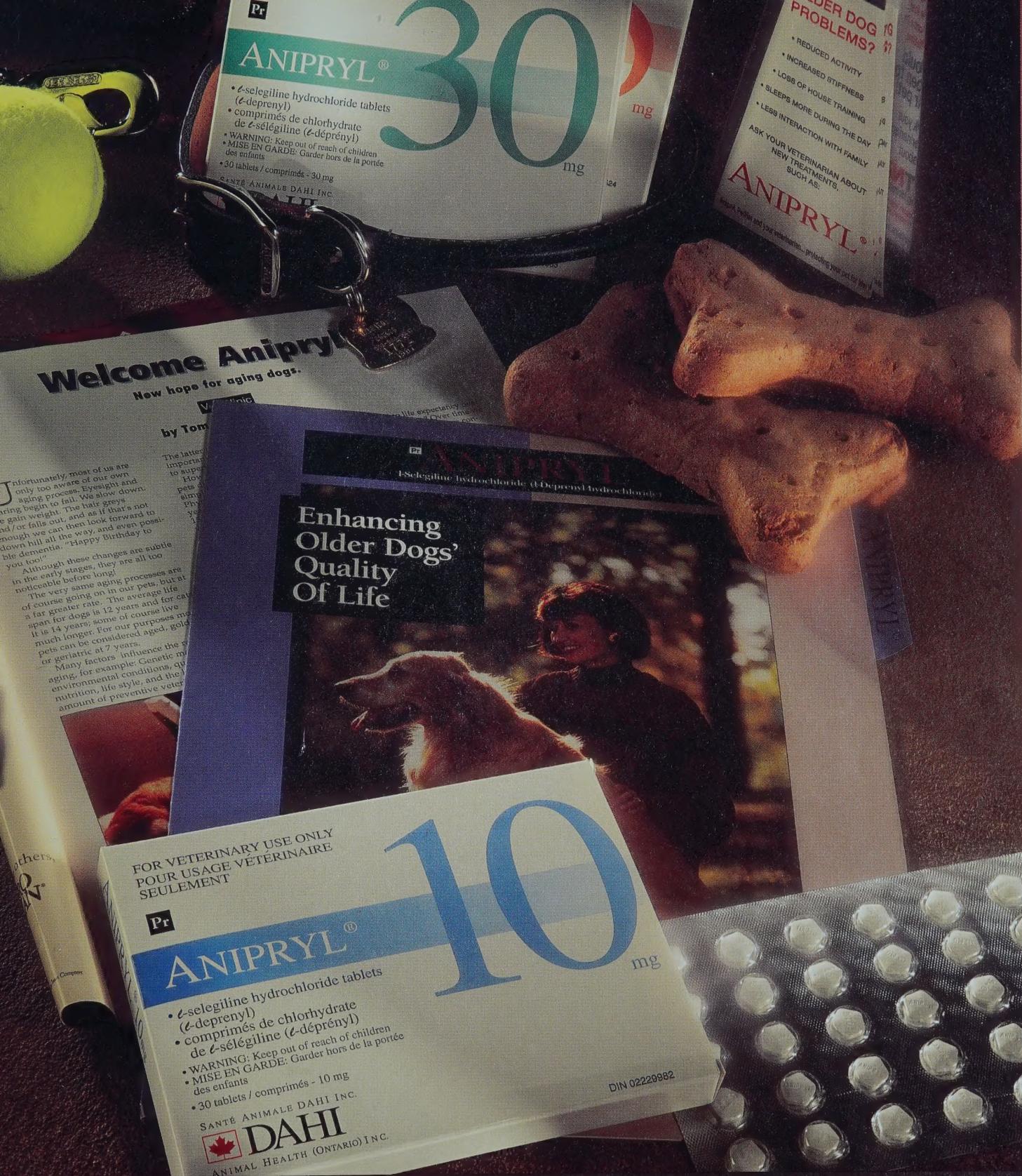
Canine cognitive dysfunction

A second, much more prevalent chronic disease is canine cognitive dysfunction, a disorder of older dogs whose behavior, including house training, has become impaired due to brain neurodegeneration. Approximately 150,000 older dogs in Canada, and 1.5 million older dogs in the US are afflicted with canine cognitive dysfunction each year. Anipryl has shown effectiveness in both laboratory and clinical settings for the treatment of canine cognitive dysfunction.

In February 1997, DRAXIS received regulatory approval from the HPB/BVD to market Anipryl for the treatment of canine cognitive dysfunction. DAHI is in the midst of the final clinical trial for this indication in the US and expects to submit a supplemental application to the FDA during the second half of 1997.

Extensive patent protection

Through its wholly-owned subsidiary, DAHI, DRAXIS has substantial intellectual property rights for the use of Anipryl in companion animals. Patents have been issued in the US, Canada, Australia and Europe. The Company intends to bring Anipryl to regulatory approval in major industrialized markets outside North America. The Company is also identifying other health product opportunities to become a multi-product animal health pharmaceutical company.



DRAKIS launched Anipryl in Canada in 1996 and is poised for US introduction in 1997.

DRAKIS now owns DAHI's substantial patent portfolio covering the veterinary use of Anipryl in North America, Western Europe and elsewhere. Anipryl is a unique formulation of L-selegiline for the treatment of canine Cushing's disease and canine cognitive dysfunction in companion animals. It has been approved for both indications in Canada. The FDA has indicated that the efficacy section of the Anipryl file is complete and supports the claim that Anipryl is effective for the treatment of the Cushing's indication.



Operations now span Canada and the US. DRAXIS successfully launched Kerasal into the US, purchased Tican Pharmaceuticals Ltd., SpectroPharm Inc. and entered into a marketing agreement for GenDerm's Zonalon. SpectroDerm, from the SpectroPharm line, will be launched into the US in the second quarter of 1997. DRAXIS operates its own advanced dermatology research and formulation development facility in St. Laurent, Québec.

Dermatology Pharmaceutical Operations

SpectroPharm

Recently acquired SpectroPharm has an array of ethical OTC products, including SpectroJel, the #1 non-soap skin cleanser in the Canadian market based on AC Nielsen ratings. SpectroDerm is the first of SpectroPharm's range of products to be introduced into the US market in a phased roll-out beginning in the North-east in the second quarter of 1997. SpectroPharm has \$3 million annual sales in Canada.

Kerasal

This is a potent keratolytic agent specifically used to alleviate dry, cracked and callused feet. The American Podiatric Medical Association states that approximately 19% of the US population suffers from podiatric, or foot, problems. This is expected to grow as the baby boom generation reaches its middle years. The product was introduced in the US in February 1996 and by the third quarter of the year, DRAXIS had successfully enrolled approximately half of the almost 4,000 US podiatrists who dispense through their offices. During the coming year, DRAXIS intends to implement strategies to achieve retail distribution in the US and then promote to the approximately 12,000 non-dispensing podiatrists.

Tican

DRAXIS broadened its dermatology product line by purchasing Toronto-based, privately held Tican Pharmaceuticals Ltd. This acquisition has provided the Company with several regulatory approved prescription and OTC dermatological compounds that are currently being sold in the US and Canada. These products include cortico-steroid creams and lotions, moisturizers, sunscreens, a compounding base and shampoos.

Essential SPA

The Essential SPA program, a line of skin care products, was specifically developed by DRAXIS' dermatology research division under the guidance of Dr. Paula Moynahan, an eminent New York Plastic and Cosmetic surgeon. This line of products is distributed, marketed and sold through Stéf International, a multi-level marketing company in which DRAXIS has a 31% equity stake.

Dermatology Research

DRAXIS holds the worldwide rights to a patented delivery system which enhances the effectiveness, safety and cost of certain prescription topical therapeutic agents as well as non-prescription skin care products. Two such prescription agents are under active development.

LipoFORT

This is a liposomed high potency steroid topical product for the treatment of inflammatory skin disorders. The early clinical stage research and development is partially funded by a Canadian government agency.

LipoTECA

This is a liposomed topical formulation developed by DRAXIS for the treatment of keloid scars, which often occur following surgery, burn or trauma. Following a successful multi-centre placebo-controlled trial in early 1996, DRAXIS concluded that there was a statistically significant difference between LipoTECA and the placebo liposome cream. As a result, a second trial is underway and is expected to be completed by mid-1997.

Levulan Photodynamic Therapy (PDT)

This is a treatment system which combines the specific photosensitizing properties of Levulan and its ability to enter specific targeted cells where its activation by light of a certain wave length causes it to precipitate a chemical conversion that destroys cells. This product is being developed by DUSA Pharmaceuticals, Inc. for the treatment of Actinic Keratoses, depilation and bladder cancer diagnosis. DRAXIS holds the Canadian rights for all Levulan applications.

Canadian Pharmaceutical Marketing Operations

A market leader in Parkinson's disease

It is now accepted that the incidence of neurodegenerative diseases increases substantially as the population ages. The marketing in 1996 of the Company's six neurology compounds in Canada, used for treating both Parkinson's disease and epilepsy, provided the Company with its principal source of revenue. Parkinson's disease is a progressive neurological disorder which causes tremors, postural abnormalities and paralysis. DRAXIS is the leading marketer in Canada of drugs for Parkinson's disease, with an approximate 22% market share in 1996.

Diversification into other areas

DRAXIS is strengthening its position in Canadian Pharmaceutical Marketing through diversification both within, and outside of neurology, by obtaining licenses to market in Canada various products which have received regulatory approval or which are in late-stage development. In early 1997, DRAXIS obtained the exclusive Canadian marketing rights to the Mylan formulation of the cancer drug, paclitaxel (taxol). The ongoing efforts to establish product clusters through new product development and strategic alliances will continue to play a pivotal role in the Company's ability to expand its market base. A review of these products follows on the next page.

Focusing on disease management

DRAXIS has garnered the Canadian marketing rights to a family of products for the treatment of the various phases of Parkinson's disease, including Eldepryl, Novo-Selegiline, Permax and Britaject.

DRAXIS has refined its ability to focus on treating a disease in its various stages and, as a result, the Company's sales representatives have developed substantial product expertise. This, in turn, has allowed them to better assist physician specialists in designing treatment plans for their patients. The Company's sponsorship of a series of grand rounds in four major Canadian teaching centres, hosted by the world-renowned Parkinson's expert, Professor Warren Olanow, is a further reflection of the Company's commitment to supporting professionals who manage Parkinson's disease.

Generic alliance with Novopharm

In 1990, DRAXIS introduced Eldepryl in the Canadian market. DRAXIS reduced its vulnerability to generic competition by entering into a distribution alliance with Novopharm in December 1993. This allowed DRAXIS to distribute its own, lower-margin generic version called Novo-Selegiline, which has ultimately surpassed Eldepryl in sales. Novo-Selegiline is listed on all provincial formularies. Novo-Selegiline has ensured that DRAXIS will continue to realize profits for Eldepryl even in the face of a second generic competitor which entered the Canadian market in February 1997.

Dr. Roger Mailhot
Vice President
Scientific & Regulatory Affairs
Draxis Health Inc.
6870 Goreway Drive
MISSISSAUGA, Ontario
L4V 1P1

Dear Dr. Mailhot:

The information and material submitted for the NDA 4885, received with your letter dated July 30, is acceptable for review as a New Drug Submission. A copy of the submission fee has been changed following the total fee. Please note:

ACCEPTANCE LETTER - SCREENING

File No. 9427
September 2
1991
Draxis Health Inc.
1000 Goreway Drive
Mississauga, Ontario
L4V 1P1
Telephone: (905) 624-1860
Telex: 800-222-1860
Facsimile: (905) 624-1861

The Company's focus on neurology, Parkinson's disease in particular, addresses one of the larger markets for chronic diseases in Canada. In its pipeline are drugs for the treatment of narcolepsy as well as for cancer, osteoporosis and renal osteodystrophy.

Canadian Pharmaceutical Pipeline

Modafinil

This drug has been licensed from Laboratoire L. Lafon of France and is currently under Canadian regulatory review for the treatment of narcolepsy, a chronic sleep disorder characterized by uncontrolled episodes of falling asleep at unexpected times and in unexpected circumstances. Narcolepsy affects up to 30,000 Canadians annually, representing a market estimated by the Company at \$2 million to \$3 million. Canada has approved no new treatment for narcolepsy since 1959.

A multi-centre clinical study across Canada, which concluded in February of 1996, confirmed that Modafinil is an effective treatment for narcolepsy. DRAXIS filed with the Canadian government in August 1996 to market Modafinil for narcolepsy, and expects commercialization in late 1997.

Patch

DRAXIS has Canadian rights to all improvements and dosage forms of Eldepryl. The Eldepryl patch, which is in Phase III trials in the US, is presently being developed by Somerset.

Liquid Eldepryl

This product was created for those Parkinson's disease patients who have difficulty handling or swallowing the Eldepryl tablet. It has been approved by the Canadian Health Protection Branch. A launch into the Canadian marketplace is being assessed.

Ipriflavone

A second generation drug for osteoporosis, Ipriflavone is currently marketed for this indication in Italy and Japan. The North American rights are held by Somerset, which is presently developing the product for regulatory approval in North America. DRAXIS has exclusive Canadian marketing rights for Ipriflavone.

One Alpha D2

This is an oral drug for the treatment of secondary hyperparathyroidism of renal failure, a complication that can affect patients on dialysis. One Alpha D2 is being developed by Bone Care International and is presently in Phase III clinical trials. DRAXIS holds royalty-free Canadian rights to this drug for all metabolic bone disease applications.

Paclitaxel

In early 1997, DRAXIS acquired from Mylan Laboratories Inc. of Morgantown, West Virginia, the exclusive Canadian marketing rights to the Mylan formulation of the cancer drug, paclitaxel. This is a novel, anti-tumor agent used in the treatment of refractory breast and ovarian cancer, and is the leading cytotoxic agent in North America. It is currently marketed under the brand name Taxol® by Bristol Myers-Squibb, with 1995 Canadian sales totaling \$13 million. DRAXIS will be responsible for obtaining HPB approval for the product, and for the marketing, distribution and sale of paclitaxel in Canada.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Revenues

Sales

1996

Sales for DRAXIS Health Inc. ("DRAXIS" or the "Company") declined by \$1,334,000 or 9.0% for the year ended December 31, 1996 as compared to the previous fiscal year. This decrease was largely attributable to the lower proportion of DRAXIS' branded drug, Eldepryl®, and the introduction of the lower-priced generic version, Novo-Selegiline. Combined sales of the two selegiline drugs declined by \$3,230,000 to \$8,901,000 in 1996 from \$12,131,000 in 1995. The decline in selegiline sales was partially offset by increased sales of Permax®, the commencement of sales of Kerasal® in the United States and Anipryl® in Canada following their 1996 market launches, the payment associated with the early return of the Canadian marketing and selling rights for the drug Prolopa® to Hoffmann-La Roche Limited and sales of products acquired by Tican Pharmaceuticals Ltd. in July 1996. Sales were also affected by the sale of New IHS, L.L.C. ("IHS") to Stéf International Corporation ("Stéf") in August 1996 and the subsequent exclusion of that company's revenues from DRAXIS' revenues. DRAXIS' share of IHS's 1996 sales to the date of disposition were \$366,000.

1995

Sales declined by \$809,000 or 5% for the year ended December 31, 1995 in comparison to the previous fiscal year despite the fact that volume sales of selegiline (in number of tablets sold) rose by 7.6% over the previous year. Sales declined because an increasing proportion of the Company's selegiline sales were of the lower-priced Novo-Selegiline product. As a result, combined sales of Eldepryl® and Novo-Selegiline declined by \$1,947,329 or 13.8%. A 25.3% increase in sales of Permax® and nine month sales of approximately \$600,000 from the Company's joint venture in IHS, helped offset the decline of selegiline revenues.

On October 1, 1995, Novo-Selegiline was listed on the Ontario Drug Benefit Plan. Novopharm Limited, one of the world's largest generic companies, now distributes Novo-Selegiline in Canada, and is expected by the Company to maintain a significant share of the generic selegiline market even after the introduction of other generic versions of selegiline. DRAXIS and Novopharm Limited share equally in the profits of these sales.

1994

Sales increased by \$1,156,000 or 7.7% for the year ended December 31, 1994 over the previous year mainly due to sales of Permax®, a drug acquired from Eli Lilly Canada Inc. on February 10, 1994. Permax® is used as a specific adjunct to levodopa in the treatment of Parkinson's disease.

Interest Income

1996

Interest income improved by \$305,000, or 25.5%, to \$1,502,000 for the year ended December 31, 1996 compared to the previous year, principally as a result of higher average cash balances arising from the net proceeds of \$11.6 million from a public offering of three million common shares in April 1996 and the net proceeds of \$9.3 million from the sale of DRAXIS' remaining interest in DUSA Pharmaceuticals, Inc. ("DUSA") in March 1996.

1995

Interest income increased \$354,000 or 41.9% to \$1,197,000 during the 1995 year compared to \$843,000 for the previous year mainly due to higher average cash reserves.

1994

Interest income increased \$534,000 to \$843,000 during the 1994 year compared to \$309,000 in 1993 mainly due to higher average cash reserves.

Management's Discussion and Analysis of Financial Condition and Results of Operations continued

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Cost of Sales

1996 Cost of sales increased from 20.8% of sales in 1995 to 22.0% in 1996 arising from the change in product mix described above.

1995 Cost of sales increased from 18.0% of sales in 1994 to 20.8% in 1995 arising from the change in product mix described above.

1994 Cost of sales increased from 16.8% of sales in 1993 to 18.0% in 1994 arising from the change in product mix described above.

Selling, General and Administration Expenses

1996 Selling, general and administration expenses increased \$4,918,000 in 1996 due mainly to higher marketing and selling costs associated with the market launches of Kerasal® into the United States and Anipryl® in Canada and the decline from 95% to 50% of DRAXIS' share of profits under the arrangement with Novopharm Limited. Selling, general and administration expenses in 1996 also increased relative to 1995 due to the consolidation of Deprenyl Animal Health, Inc.'s ("DAHI's") operating expenses for the period from completion of the share exchange transaction (i.e., December 1, 1996) to December 31, 1996.

1995 Selling, general and administration expenses in 1995 increased \$2,852,000 or 39.3% over the year earlier. A significant part of this increase is attributable to increased marketing, distribution, and profit sharing costs associated with the profit sharing arrangement with Novopharm Limited. Also responsible for this increase were costs associated with the launch of Kerasal® into the United States and non-recurring costs associated with the start up of IHS and the subsequent restructuring, repositioning and relaunch of its product line. Partially offsetting these increases was a decrease in the Lipopharm division operating costs. All other operating costs were approximately the same as in the prior year.

1994 Selling, general and administration expenses declined in 1994 by \$2,243,000 or 23.6%, mainly the result of the Company's cost reduction program. Administrative expenses declined \$261,000 or 7.0% from \$3,732,000 in 1993 to \$3,471,000 in 1994. Marketing and selling expenses decreased \$1,350,000 or 23.4% from \$5,777,000 in 1993 to \$4,427,000 in 1994 despite the launch of a new product, Permax®, and the absorption of a portion of the marketing costs of Novo-Selegiline.

Research and Development

1996 Research and development costs in 1996 declined to \$1,478,000 from \$2,318,000 a year earlier following substantial completion of the development of Modafinil in the first half of 1996. Research and development activity on LipoTECA™ continued during the year. These expenditures will increase as new products are added to the development pipeline. The decline in research and development costs in 1996 was partly offset as a result of the consolidation of DAHI's research and development costs for the period from completion of the share exchange transaction (i.e., December 1, 1996) to December 31, 1996.

1995 Research and development costs in 1995, mainly associated with the development of Modafinil and LipoTECA™ increased 11.5% to \$2,318,000 from \$2,079,000 one year earlier. Modafinil results showed a statistically significant difference in reducing excessive somnolence in narcoleptic patients when

Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

compared to a placebo. Similarly, the first clinical study with LipoTECA™ demonstrated a statistically significant difference against placebo in the treatment of keloids.

The Company received permission to market a liquid form of Eldepryl® in Canada, but has determined to delay its launch of this product until it has completed further tests to determine the most appropriate use of the drug.

1994 Research and development costs in 1994 were \$2,079,000; a decrease of \$643,000 or 23.6% as funds designated for the development of a sustained release tablet were cancelled. The Company continued to demonstrate its commitment to research and development; spending \$2,079,000 or 12.8% of sales.

Depreciation and Amortization

1996 Effective January 1, 1996, DRAXIS adopted a policy of amortizing the cost of product licenses on a straight line basis over the minimum term of the related license agreements. Prior to 1996, the cost of product licenses were amortized on the basis of actual product sales during a period as a percentage of total estimated sales over the minimum term of the related license agreement. As the aggregate, cumulative effect of this change on prior periods is not significant, prior years' figures have not been restated.

Amortization and depreciation expense increased by \$410,000 to \$1,695,000 in 1996 as compared to \$1,285,000 in 1995. This increase is attributable to the change in accounting policy described above, increased fixed asset depreciation, the commencement of the amortization of the cost of the Anipryl® US patent rights and Canadian license and goodwill associated with the acquisition of Tican Pharmaceuticals Ltd.

1995 Included in this expense category in 1995 are the amortization of the cost of the Company's Eldepryl® and Permax® licenses with Somerset Pharmaceuticals, Inc. and Eli Lilly Canada Inc., respectively, which were amortized on the basis of actual sales during the year as a percentage of anticipated sales over the term of the licenses, the amortization of the goodwill on the acquisition of Lipopharm and the depreciation of fixed assets.

On October 1, 1995, The Ontario Drug Formulary made Eldepryl® subject to generic substitution, the last formulary to do so. As a direct consequence, the Company decided to review its sales forecast of both Eldepryl® and Permax® and accelerated the amortization of both of these licenses, incurring an increase in the annual rate of amortization of approximately \$296,000.

Amortization and depreciation expense increased by \$419,000 to \$1,285,000 in 1995 as compared to \$866,000 in 1994. This increase is attributable to the increased rate of amortization described above and increased fixed asset depreciation.

1994 Amortization and depreciation expense increased by \$273,000 to \$866,000 in 1994 as compared to \$593,000 in 1993. This increase is attributable to the commencement of the amortization of the cost of the Permax® license acquired in February 1994.

Gain on Sale of Securities

1996 During 1996, the Company disposed of its remaining interest in DUSA resulting in a pre-tax gain of \$6,001,000. In addition, during the year the Company disposed of its remaining interest in Medicis Pharmaceutical Corporation for a pre-tax gain of \$110,000.

Management's Discussion and Analysis of Financial Condition and Results of Operations continued

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- 1995 DRAXIS continued the liquidation of its non-affiliate equity investments in 1995 until they were completely converted into cash and treasury bills. The gain of \$549,000 in 1995 is composed of the reversal of the 1994 reserve of \$732,000 less a loss of \$183,000 on the disposition of the remainder of the portfolio.
- 1994 In October 1992, the Company undertook a gradual disposition of its non-affiliate equity investments. The Company continued the liquidation of its portfolio throughout 1993 and 1994 resulting in a gain on disposition of \$58,000 in 1994. At December 31, 1994, the cost of the portfolio was \$732,000 above the market value and, as such, a provision for unrealized investment losses in a similar amount was set up.
- Other Income (Expense)***
- 1996 There were no items included in this category during 1996.
- 1995 Included as other income in 1995 are a gain of \$1,833,000 on the dilution of the Company's investment in DUSA as a result of that company's public offering in December 1995, and a gain of \$3,067,000 on the sale of DRAXIS' option to purchase two million shares of DUSA.
- 1994 Included as other expense in 1994 were severance costs of \$202,000, a gain on dilution of the Company's investment in DUSA of \$219,000 and a loss from operations of Bone Health Inc.
- Income Taxes (Recoverable)***
- 1996 For the year ended December 31, 1996, DRAXIS recorded a recovery of income taxes of \$318,000 based on income before income taxes and equity share of loss of affiliated companies of \$725,000, as compared to a provision of \$2,064,000 on income before income taxes and equity share of loss of affiliated companies of \$6,014,000 in 1995. The difference between the amount of income tax which would have been provided for in 1996 based on statutory income tax rates and the effective rate used in determining the amount of the recovery for the year is attributable to the lower effective tax rate on capital gains recognized on the sale of the Company's remaining interest in DUSA.
- 1995 Income taxes increased to \$2,064,000 in 1995 from \$1,740,000 in 1994 reflecting the increase in income before income taxes. The Company's effective tax rate decreased to 34% in 1995 from 35% in 1994 due to the lower tax rate on capital gains generated by the Company during the year.
- 1994 Income taxes increased to \$1,740,000 in 1994 from a recovery of income taxes of \$966,000 in 1993 due to the loss before income taxes. The Company's effective tax rate decreased to 35% in 1995 from 57% in 1994 due to a change in applicable income tax rates, the impact of capital transactions and the utilization of previously unrecorded income tax loss carry forwards.

Equity Share of Loss of Affiliated Companies

During 1996, DRAXIS acquired all the shares of one of its equity affiliates, DAHI, not already owned by it through a mandatory share exchange and disposed of its remaining interest in another of its equity affiliates, DUSA. As at December 31, 1996, DRAXIS held an equity interest in only one affiliate, St  f.

Management's Discussion and Analysis of Financial Condition and Results of Operations continued

**Deprenyl
Animal
Health, Inc.**

On March 14, 1991, DAHI completed an initial public offering, generating US \$4,658,000 net of offering expenses to fund the development of Anipryl®. DRAXIS held 2,460,000 shares or 57.7% of DAHI before the public offering and was diluted to 38.8% as a result of the offering. At December 31, 1993, DRAXIS' investment in DAHI was reduced further to 33% due in large part to the exercise of stock options.

On May 1, 1994, DRAXIS advanced US\$2.5 million to DAHI in the form of convertible debt. On January 9, 1995, the Company purchased 170,000 shares¹⁶ of DAHI on the open market at \$2.40 per share thus increasing its equity interest to 35.7%.

As at June 30, 1995, the Company's equity share of the losses of DAHI had fully amortized the cost of its investment in DAHI. Accordingly, the Company was not required to and did not equity account for any further losses of DAHI for the remainder of the year. At December 31, 1995, apart from the 1996 Loan made in connection with the DAHI Distribution Agreement, the Company's management had no intention of making any further investment in DAHI. The equity share of the losses of DAHI recorded in the books of DRAXIS in 1995 was \$577,000 and the portion of unrecognized loss that would otherwise have been recorded at December 31, 1995 was \$685,000.

On January 10, 1996, the Company entered into the DAHI Distribution Agreement, under which DRAXIS acquired the rights to market Anipryl® in Canada in consideration of the payment of a licensing fee of US \$469,000 plus marketing expenses of US \$125,000. In connection with entering into the DAHI Distribution Agreement, DRAXIS advanced the 1996 Loan to DAHI and converted US \$1,545,000 of the 1994 Loan into DAHI shares at \$2.11, acquiring 993,999 shares of DAHI in the process to hold indirectly 44%. As a result, the Company again began to record its equity share of the losses of DAHI.

In June 1996, shareholders of DAHI approved the conversion feature of the US \$1,000,000 advance made by the Company to DAHI in January 1996 and the Company clarified its commitment with respect to the future financing requirements of DAHI. As a result, in the second quarter of 1996, the Company recorded its share of DAHI's net development stage expenses of \$685,000, which had not been previously recognized for accounting purposes.

In November 1996, shareholders of both DRAXIS and DAHI approved the acquisition by DRAXIS of all the shares of DAHI not already owned by DRAXIS through a mandatory share exchange. Effective November 26, 1996, DAHI became a wholly-owned subsidiary of DRAXIS. Accordingly, the results for the fourth quarter of 1996 include the results for DAHI on a fully consolidated basis from December 1, 1996 through December 31, 1996. Prior to December 1, 1996, DAHI's results were accounted for by using the equity method and were therefore included as part of DRAXIS' equity share of loss of affiliated companies. As a result of the DAHI transaction, DRAXIS recorded an increase in patents, licenses and other deferred charges of \$27,137,000 which will be amortized on a straight line basis over a period of 10 years.

The Company's 1996 equity share of loss of affiliated companies includes a reversal of \$697,000 of deferred taxes which had been applied to dilution gains associated with common share offerings of DAHI in 1990 and 1991.

In connection with the acquisition of DAHI and subject to good business judgement, the Company intends to commit approximately US \$10,000,000 to DAHI to complete the process of obtaining approval from the United States Food and Drug Administration for Anipryl®, to launch Anipryl® in the United States and to acquire and develop new veterinary products.

**DUSA
Pharmaceuticals,
Inc.**

Management's Discussion and Analysis of Financial Condition and Results of Operations continued

On January 17, 1992, DUSA completed its initial public offering which raised US \$14,785,000, net of offering expenses, to fund development of Levulan™ Photodynamic Therapy, at which time DRAXIS' then 100% holding was diluted to 21.4%.

On March 4, 1994 and November 23, 1993, DUSA issued 250,000 and 100,000 shares, respectively in private placements generating US \$1.7 million in aggregate proceeds, further diluting DRAXIS' interest to 20%. On December 14, 1995, DUSA issued three million shares in a public offering generating proceeds of US \$16.5 million before underwriting expenses. The Company's equity interest was consequently reduced from 20% to 12.8%.

On March 11, 1996, the Company sold its remaining 12.8% in DUSA in a US public offering generating net proceeds of \$9.3 million.

DRAXIS continues to hold the rights from DUSA to market all Levulan™ PDT products for all indications in Canada.

**Stéf
International
Corporation**

In August 1996, the Company transferred its ownership interest in the joint venture IHS to Stéf. Prior to the transaction, the Company converted its loans and promissory notes due from IHS to a capital contribution, thereby increasing its ownership interest to 92%. The Company's ownership interest in IHS was then transferred to Stéf in exchange for 3,000,000 common shares valued at \$1,350,000 and a note receivable for \$728,000. The note bears interest at the bank prime rate plus 1% per annum and is payable quarterly with principal due August 6, 2001. All amounts due may be converted at the option of the Company into common shares of Stéf at \$0.75 per share. Concurrently, the Company purchased from Stéf's treasury 1,000,000 units for \$500,000. Each unit consisted of one common share and 0.87 warrants. Each warrant is exercisable for one common share at \$0.75 per share if exercised by July 31, 1998 and at \$1.00 per share if exercised by July 31, 1999.

The Company recorded its initial investment in Stéf based on the carrying value of its interest in IHS plus the amount of its additional investment as described above.

As at December 31, 1996, DRAXIS held common shares representing approximately 30.8% of Stéf's issued and outstanding shares.

As at December 31, 1996, DRAXIS' investment in Stéf was carried at \$1,432,000 which included the Company's share of losses of \$254,000 incurred in 1996 since the acquisition of IHS by Stéf. As at December 31, 1996, the sum of the principal value of the Stéf note held by DRAXIS plus the market value of DRAXIS' common share holding in Stéf was \$2,328,000.

Liquidity and Capital Resources

1996

Cash and cash equivalents at December 31, 1996, were \$25,828,000 an increase of \$9,222,000 over the balance at December 31, 1995, of \$16,606,000. The increase in cash during the year is attributable to the net proceeds from the common share issuance and the proceeds from the sale of the Company's remaining interest in DUSA partially offset by cash consumed in operations after changes in working capital of \$6,690,000 and cash consumed in investing activities including \$1,139,000 in license milestone payments.

In addition to its cash and cash equivalent holdings, at December 31, 1996, DRAXIS held approximately 2.7% of the issued and outstanding common shares of Bone Care International, Inc. with a carrying value of \$691,000 and a market value at December 31, 1996, of \$1,176,000.

Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

1995

The Company's cash and working capital at December 31, 1995, were \$16.6 and \$16.4 million, respectively, compared to \$11.7 and \$12.5 million, respectively, in 1994.

Operations generated a positive cash flow of \$2,267,000; down \$4,028,000 from the previous year as a result of the following: lower margins on sales of Novo-Selegiline in comparison to sales of Eldepryl®; non-recurring costs associated with the launch of Kerasal® into the United States; and non-recurring costs at IHS associated with the start up of the joint venture and the subsequent repositioning and relaunch of its product line.

Cash flow decreases were partially offset by the following: increased profitability on increased sales of Permax® and decreased losses within the dermatological division. The major capital outlay the Company incurred in 1995 was the second payment of \$1,000,000 for the acquisition of Permax® from Eli Lilly Canada Inc. The Company also acquired the Canadian rights to Ipriflavone, a drug indicated for the treatment of osteoporosis, from Somerset for \$141,000.

1994

Cash flow from operations added \$6,295,000 to the Company's cash position in 1994. The main uses of cash included the first milestone payment of \$2,000,000 for the acquisition of Permax® from Eli Lilly Canada Inc., a loan to DAHI of \$3,432,000 (US \$2,500,000) and the payment of the income taxes of \$1,663,000 on the profit in the previous year on the sale of DRAXIS shares held by the Company's wholly-owned subsidiary, Viapharm Inc.

The net result was a year-over-year reduction in the Company's cash position of \$514,000 from \$12,205,000 at the end of 1993 to \$11,691,000 at the end of 1994. Working capital at December 31, 1994, was \$12,512,000, down \$2,580,000 from the previous year for the reasons outlined above.

Outlook

Subsequent to the 1996 year end, during the period January 1, 1997 to April 18, 1997, DRAXIS made several announcements including:

- Receipt of an "approvability letter" from the US Food and Drug Administration confirming that the efficacy section of the Anipryl® file is now complete and supports the claim that Anipryl® is effective for the treatment of canine Cushing's disease;
- Acquisition from Mylan Laboratories Inc. of the Canadian marketing rights to the Mylan formulation of paclitaxel;
- Canadian regulatory approval of Anipryl® for the treatment of canine cognitive dysfunction;
- Acquisition of SpectroPharm Inc. together with the worldwide rights to its six dermatology products;
- Issuance by the European Patent Office of a patent for the use of Anipryl® in the treatment of dogs with conditions including canine Cushing's disease and canine cognitive dysfunction;
- Issuance by the Canadian Intellectual Property Office of a patent for the use of Anipryl® in the treatment of canine cognitive dysfunction;
- Acquisition from GenDerm Canada Inc. of the exclusive Canadian rights to promote Zonalon®, a patented prescription anti-pruritic cream used in the treatment of moderate to severe pruritis; and
- Signing of a letter of intent to acquire the Frosst Radiopharmaceuticals division from Merck Frosst Canada Inc.

Management believes that it has an opportunity to increase product revenues in 1997 over 1996 levels as a result of the acquisitions of Frosst Radiopharmaceuticals, SpectroPharm Inc., Tican Pharmaceuticals Ltd. and the receipt of final regulatory approvals for and the subsequent market launches of Anipryl® in the US and Modafinil in Canada.

Management's Discussion and Analysis of Financial Condition and Results of Operations continued

For at least the first six months of 1997, it is anticipated that EBITDA will continue in a loss position primarily as a result of the consolidation of DAHI's operating results and increased levels of expenditure associated with product launch programs. The achievement of positive operating earnings in the second half of 1997 will be largely dependent on the timing and level of Anipryl® sales in the United States and the completion of the proposed acquisition of Frosst Radiopharmaceuticals in the second quarter of 1997.

Interest income in 1997 will be lower than the amount recorded in 1996 as a result of lower cash holdings due, in part, to the acquisitions of Frosst Radiopharmaceuticals and SpectroPharm Inc.

Depreciation and amortization expense will increase in 1997 and beyond as a result of non-cash charges arising from the acquisitions of DAHI, SpectroPharm Inc. and Frosst Radiopharmaceuticals.

Veterinary Pharmaceutical Unit

The outlook for the Veterinary Pharmaceutical Unit is dependent on the timing of receipt of final United States regulatory approval for Anipryl® for the treatment of canine Cushing's disease which is currently expected to be received in June 1997, and the timing and level of subsequent sales of Anipryl® in the United States.

Canadian experience with Anipryl® suggests that the rate of market penetration is a gradual process and is dependent on the rate at which new cases present to veterinarians and the willingness of pet owners to encourage treatment for their ageing companion animal. The second six month period after the launch in Canada is showing steady month-over-month increases in revenue. No significant competition from products approved for veterinary or human use has been experienced to date in Canada. Anipryl® is protected by patents in Canada, the United States and other jurisdictions.

Dermatology Pharmaceutical Unit

The Dermatology Pharmaceutical Unit should experience growth in 1997 following the acquisitions of SpectroPharm Inc., Tican Pharmaceuticals Ltd. and the Canadian rights to promote Zonalon®. SpectroPharm's lead product is being launched in the US in 1997 on a phased regional basis and the Company is optimistic about its prospects in this market. DRAXIS also expects continued growth from the SpectroPharm products in the Canadian market.

The Dermatology Research Division is expected to complete its second set of placebo-controlled clinical trials on LipoTECA™ in the third quarter of 1997. Considerable work remains to be done on the LipoTECA™ formulation before a regulatory submission can be made.

Canadian Pharmaceutical Unit

Since 1993, DRAXIS has been implementing strategies to address the genericization of Eldepryl® including the 1993 agreement with Novopharm Limited to sell and share profits from its own generic version of Eldepryl®. In the Company's 1995 Annual Report, it was noted that the Company expected the introduction of a second Canadian generic competitor for Eldepryl® in 1996. A second competitor entered the generic selegiline market in February 1997. It is expected that this development will result in lower revenues and margins from the Company's selegiline products.

Novopharm Limited has indicated its willingness to extend, for no consideration, the profit sharing arrangement involving sales of Novo-Selegiline for a five year period beyond the expiration of the existing agreement in December 1998.

DRAXIS expects to receive Canadian regulatory approval for Modafinil in the third quarter of 1997 and sales to commence in the fourth quarter.

The Company currently expects to have sufficient information from Mylan Laboratories Inc. to complete a Canadian filing for paclitaxel in the fourth quarter of 1997. Regulatory approval is expected

Management's Discussion and Analysis of Financial Condition and Results of Operations *continued*

to take at least 18 months from filing. There is no assurance that the Canadian regulatory authorities will accept the generic equivalence of this form of paclitaxel with the branded version of the drug.

The 1996 sales target, which was a condition to the renewal of the sub-license for the Canadian marketing and distribution rights to Permax® which expire on December 31, 1998, were not achieved. The Company has entered into discussions with Eli Lilly Canada Inc. regarding the extension of this agreement.

Radio-pharmaceutical Unit

The acquisition of Frosst Radiopharmaceuticals, with profitable annualized revenues of approximately \$6 million, is expected to be completed in the second quarter of 1997 and will contribute to DRAXIS' revenues and operating profits thereafter. Operating results from this business are expected to be relatively stable during the two year transition period following acquisition.

Investments

DRAXIS continues to hold a 2.7% interest in Bone Care International, Inc. (NASDAQ: BCII) and retains the Canadian rights, royalty-free, to its lead product, One Alpha D2®.

In response to continuing operating losses, Stéf management is implementing new business plans with the objectives of reducing costs and increasing revenues. In addition, Stéf is undertaking efforts to attract new capital funds. No assurance can be given that these initiatives will be successful. If Stéf is unsuccessful in achieving its objectives, the carrying value of the Company's investment in Stéf may require revaluation. DRAXIS' investment in Stéf is not considered to be one of the Company's core pharmaceutical holdings and accordingly, DRAXIS does not intend to make any significant future capital investments in Stéf.

Liquidity and Capital Resources

Cash flow from operations, before changes in working capital, is expected to be close to break-even by the end of 1997 although achievement of this result will be largely dependent on the timing of receipt of US regulatory approval for Anipryl® and the level of Anipryl® sales in the United States following approval.

The sources of the Company's liquidity as at December 31, 1996 were holdings of cash and cash equivalents aggregating \$25.8 million and the interest in Bone Care International, Inc. which, at year-end, had a market trading value of \$1.2 million.

Excluding the impact of the acquisition of Frosst Radiopharmaceuticals, the Company's existing liquid holdings are expected to be sufficient to fund current operations and their associated capital requirements in 1997. Expenditures associated with the proposed acquisition of Frosst Radiopharmaceuticals are expected to be funded by a combination of external financing arrangements, DRAXIS' existing cash resources and cash flow from operations.

The Company follows a policy of investing its surplus cash resources in high quality, liquid, short term commercial paper and government treasury bills. There are no restrictions on the flow of these funds nor have any of these funds been committed in any way at this time, except as stated.

Except for historical information, the foregoing contains certain forward-looking statements that involve risk and uncertainties, which may cause actual results to differ materially from the statements made. Such factors include, but are not limited to, changing market conditions, clinical trial results, the establishment of new corporate alliances, the impact of competitive products and pricing, the timely development, regulatory approval and market acceptance of the Company's products, and other risks detailed from time-to-time in the Company's filings with the United States Securities and Exchange Commission and Canadian securities authorities.

DRAxis Health Inc. Management's Responsibility for Consolidated Financial Statements

The accompanying consolidated financial statements of DRAxis Health Inc. and its affiliated companies and all information in the Annual Report are the responsibility of management and have been approved by the Board of Directors. The financial statements necessarily include some amounts that are based on management's best estimates, which have been made using careful judgement.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the Annual Report are consistent with the information contained in the financial statements.

In fulfilling their responsibilities, management of DRAxis Health Inc. and its affiliated companies have developed and continue to maintain systems of internal accounting controls including written policies and procedures and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded, and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility for the financial statements in this Annual Report principally through its Audit Committee, consisting solely of two non-executive directors and one executive director. The Audit Committee meets regularly with management and the external auditors to discuss the results of audit examinations with respect to the adequacy of internal accounting controls and to review and discuss the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche, Chartered Accountants, who have full access to the Audit Committee.



Martin Barkin, MD, FRCSC
President and Chief Executive Officer



Jim Garner, CA
Vice President Finance and Chief Financial Officer
Mississauga, Ontario
February 6, 1997

Auditors' Report

To the Shareholders of
DRAXIS Health Inc.

We have audited the consolidated balance sheets of DRAXIS Health Inc. as at December 31, 1996 and 1995 and the consolidated statements of operations, retained earnings and cash flows for each of the years in the three year period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995 and the results of its operations and cash flows for each of the years in the three year period ended December 31, 1996 in accordance with generally accepted accounting principles.

Deloitte & Touche

Chartered Accountants
Toronto, Ontario
February 6, 1997
except for Note 19, which
is as of February 14, 1997

Consolidated Balance Sheets

D R A X I S H e a l t h I n c.

*(in thousands of Canadian dollars
except share related data)*

December 31,

	1996	1995
Assets		
Current		
Cash and cash equivalents	\$ 25,828	\$ 16,606
Accounts receivable (Note 3)	2,397	1,486
Income taxes recoverable	877	170
Inventory	1,909	705
Prepaid expenses	442	796
	31,453	19,763
Long-term receivables (Note 4)	-	4,992
Long-term investments (Note 5)	2,123	3,931
Fixed assets (Note 6)	737	545
Goodwill (Net of accumulated amortization: 1996 – \$1,011; 1995 – \$744)	2,196	1,663
Patents, licenses and other deferred charges (Note 7)	30,694	4,158
Deferred income taxes (Note 8)	336	-
	\$ 67,539	\$ 35,052
Liabilities		
Current		
Accounts payable and accrued charges	\$ 2,746	\$ 1,569
Royalties payable	963	1,335
Current portion of license obligation (Note 9)	-	500
	3,709	3,404
Deferred income taxes (Note 8)	-	1,799
Shareholders' Equity		
Common stock; unlimited shares authorized, issued and outstanding: 1996 – 29,263,602; 1995 – 20,126,718 shares (Note 10)	52,813	18,666
Preferred stock; unlimited shares authorized, none outstanding	-	-
Employee participation shares; 2,000,000 shares authorized, issued and outstanding: 1996 – 1,319,000; 1995 – 1,530,000	396	459
Less: loans receivable	(396)	(459)
Contributed surplus	9,701	9,701
Retained earnings	1,316	1,482
	63,830	29,849
	\$ 67,539	\$ 35,052

See the accompanying notes to the Consolidated Financial Statements

Approved by the board



Director



Director

**Consolidated Statement of
Retained Earnings**

D R A X I S H e a l t h I n c.

(in thousands of Canadian dollars
except share related data)

Years ended December 31,

	1996	1995	1994
Balance at beginning of the year	\$ 1,482	\$ (935)	\$ (1,747)
Net (loss) income for the year	(166)	2,417	1,099
Adjustment for Bone Health Inc. amalgamation (Note 2)	-	-	(287)
Balance at end of the year	\$ 1,316	\$ 1,482	\$ (935)

See the accompanying notes to the Consolidated Financial Statements

Consolidated Statements of Operations

D R A X I S H e a l t h I n c.

*(in thousands of Canadian dollars
except share related data)*

Years ended December 31,	1996	1995	1994
<i>Revenues</i>			
Sales	\$ 14,100	\$ 15,434	\$ 16,243
Interest income	1,502	1,197	843
	15,602	16,631	17,086
<i>Expenses</i>			
Cost of sales	3,109	3,210	2,921
Selling, general and administration	15,036	10,118	7,266
Research and development	1,478	2,318	2,079
Investment tax credits on research and development	(296)	(484)	(456)
Research and development recovered from an affiliated company	(34)	(381)	(534)
Depreciation and amortization	1,695	1,285	866
	20,988	16,066	12,142
(Loss) income from operations	(5,386)	565	4,944
Gain on sales of securities	6,111	549	58
Other income (expense) (Note 11)	-	4,900	(68)
Income before income taxes and equity share of loss of affiliated companies	725	6,014	4,934
Income Taxes (Note 12)			
Current	1,121	1,335	1,630
Deferred	(1,439)	729	110
	(318)	2,064	1,740
Income before equity share of loss of affiliated companies	1,043	3,950	3,194
Equity share of loss of affiliated companies (Note 13)	(1,209)	(1,533)	(2,095)
Net (loss) income for the year	\$ (166)	\$ 2,417	\$ 1,099
(Loss) earnings per share (Note 14)	\$ (0.01)	\$ 0.12	\$ 0.06
Weighted average number of shares outstanding	22,545,890	20,058,062	19,927,427

See the accompanying notes to the Consolidated Financial Statements

Consolidated Statements of Cash Flows

D R A X I S H e a l t h I n c.

*(in thousands of Canadian dollars
except share related data)*

Years ended December 31,

	1996	1995	1994
Cash flows (used in) from operating activities (Note 20)	\$ (6,690)	\$ 2,267	\$ 6,295
<i>Cash flows (used in) from investing activities</i>			
Acquisition of fixed assets	(245)	(219)	(119)
License milestone payments	(1,139)	(1,000)	(2,000)
Investment in Bone Care International, Inc.	(82)	-	-
Proceeds from sale of shares of DUSA Pharmaceuticals, Inc.	9,323	-	-
Proceeds from sale of option in DUSA Pharmaceuticals, Inc.	-	3,067	-
Acquisition of Tican Pharmaceuticals Ltd. (net of cash acquired)	(912)	-	-
Acquisition of Deprenyl Animal Health, Inc. (net of cash acquired)	(22,899)	-	-
(Increase) decrease in other deferred charges	(28)	8	(5)
Acquisition of subsidiary and affiliated companies	(958)	(428)	(298)
Funding of joint venture prior to divestiture	(356)	-	-
Extinguishment of loans to joint venture	1,039	-	-
Loan to St�f International Corporation	(728)	-	-
Loan to Deprenyl Animal Health, Inc.	(1,361)	-	-
Net cash flows (used in) from investing activities	(18,346)	1,428	(2,422)
<i>Cash flows from (used in) financing activities</i>			
Common share offering, net of related expenses	11,562	-	-
Shares issued on the acquisition of Tican Pharmaceuticals Ltd.	200	-	-
Shares issued on the acquisition of Deprenyl Animal Health, Inc.	21,486	-	-
Income taxes paid on sale of Company shares owned by subsidiary	-	-	(1,663)
Issuance of shares for subsidiary acquisition	-	-	297
Other long-term receivables	111	946	(3,034)
Other issuances of shares	899	274	13
Net cash flows from (used in) financing activities	34,258	1,220	(4,387)
Net increase (decrease) in cash and cash equivalents	9,222	4,915	(514)
Cash and cash equivalents at beginning of the year	16,606	11,691	12,205
Cash and cash equivalents at end of the year	\$ 25,828	\$ 16,606	\$ 11,691

Cash and cash equivalents comprise cash, commercial paper and treasury bills

See the accompanying notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

(in thousands of Canadian dollars
except share related data)

1. Summary of Significant Accounting Policies

Consolidation and accounting for long-term investments

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, DRAXIS Pharmaceutica Inc., DRAXIS Animal Health (Canada) Inc., DRAXIS US, Inc., DRAXIS, L.L.C., Viapharm Inc., DAHI Animal Health Inc., DAHI Animal Health (Ontario) Inc., Deprenyl Animal Health, Inc. and Tican Pharmaceuticals Ltd. (amalgamated with the Company subsequent to year-end).

Prior to November 27, 1996, the Company's investment in Deprenyl Animal Health, Inc., a company incorporated in the United States to engage in the research, development and marketing of pharmaceutical products for veterinary prescriptive applications, was accounted for using the equity method. Effective November 27, 1996, the Company acquired the remaining outstanding shares of Deprenyl Animal Health, Inc.

The Company's investment in Stéf International Corporation, a network marketing company which distributes nutritional and personal care products, is accounted for using the equity method. As of December 31, 1996, the Company held a 30.8% interest in Stéf International Corporation.

The Company's 50% interest in the joint venture New IHS, L.L.C. was recognized in the financial statements of the Company using the proportionate consolidation method until August 13, 1996, at which time the Company sold its entire investment to Stéf International Corporation.

The Company's investment in DUSA Pharmaceuticals, Inc. was accounted for using the equity method until December 14, 1995, at which time DUSA Pharmaceuticals, Inc. completed the sale of additional common stock in a public offering. The Company incurred a dilution of its investment from 20.0% to 12.8%. The Company's investment in DUSA Pharmaceuticals, Inc. is recorded at cost after December 14, 1995. On March 11, 1996, the Company disposed of its remaining investment.

The Company's investment in Bone Care International, Inc. is recorded at cost.

Goodwill

Goodwill, which relates to the acquisitions of Lipopharm Inc. and Tican Pharmaceuticals Ltd., is recorded as an asset and is amortized on a straight-line basis over ten years.

On an ongoing basis, management reviews the valuation and amortization of goodwill, including any events and circumstances which may have impaired the fair value. The amount of goodwill impairment, if any, is determined by assessing recoverability based on expected, discounted, future cash flows using a discount rate reflecting the Company's cost of capital.

Inventory

Inventory is valued at the lower of cost and net realizable value and is determined on a first-in, first-out basis.

Fixed assets

Fixed assets are recorded at cost. The Company provides for depreciation using the following methods and applying rates estimated to amortize the cost over the useful life of the assets:

Computer equipment	30% diminishing balance
Laboratory equipment	30% diminishing balance
Furniture and equipment	20% diminishing balance
Leasehold improvements	straight-line over 5 years

Patents, licenses and other deferred charges

Patents, which relate to the development of Anipryl®, a selegiline product, for use in veterinary prescriptive applications, are recorded at cost and amortized on a straight-line basis over 10 years.

**Notes to the
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Licenses and other deferred charges are recorded at cost and consist of licenses to market certain regulatory approved pharmaceutical products in defined territories and the right to technical assistance. The Company provides for amortization of licenses on the straight-line basis over the minimum term of the license agreement which, in the case of the Eldepryl® license is 15 years, Permax® 5 years and Anipryl® 10 years. This policy was changed during 1996, from that of the previous years, whereby amortization of licenses was provided for on the basis of actual sales during the period as a percentage of total estimated sales over the minimum term of the license agreement. As the effect of the change in prior periods is not significant, the prior years' figures have not been restated.

The cost of the right to technical assistance is amortized on a straight-line basis over the minimum term of the agreement which is 15 years.

Research and development costs

Research and product development costs, including the cost of licenses for products under development, net of any government assistance and investment tax credits, are charged to earnings in the period in which they are incurred.

Foreign currency translation

Monetary assets and liabilities of integrated foreign subsidiaries are translated into Canadian dollars at the exchange rates in effect at the balance sheet date. Non-monetary items are translated at historical exchange rates. Revenue and expense items are translated at average exchange rates during the year. Exchange gains or losses arising on translation are included in the determination of net income for the year, except for long-term monetary assets and liabilities which are deferred and amortized over the remaining lives of the related items on a straight-line basis.

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses for the year then ended. Actual results may differ from such estimates.

Comparative information

The Company has reclassified the presentation of certain prior years' information to conform with the current presentation format.

2. Acquisitions

Deprenyl Animal Health, Inc.

Prior to November 27, 1996, the Company owned approximately 44% of the outstanding common shares of Deprenyl Animal Health, Inc. ("DAHI"). Effective November 27, 1996, the Company acquired the remaining outstanding shares of DAHI through a share exchange plan which provided for the mandatory exchange of each share of DAHI common stock for 1.35 shares of the Company's common stock, or 5,729,701 shares of common stock in the aggregate. The investment in DAHI was accounted for using the equity method prior to November 27, 1996 and has been consolidated subsequent thereto.

Notes to the

Consolidated Financial Statements *continued*

(December 31, 1996 and 1995)

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2. Acquisitions *continued*

The acquisition was accounted for using the purchase method, as follows:

<i>Assets</i>	
Cash	\$ 503
Prepaid expenses	8
Inventory	393
Fixed assets	91
Patents and trademarks	27,137
	28,132
<i>Liabilities</i>	
Accounts payable	818
Notes payable	3,466
	4,284
Net assets	23,848
Equity position at date of acquisition	(446)
Total acquisition cost	\$ 23,402
<i>Consideration</i>	
Cash	\$ 1
Common shares	21,486
Acquisition costs	1,915
	\$ 23,402

Tican Pharmaceuticals Ltd.

On July 25, 1996, the Company acquired all of the outstanding shares of Tican Pharmaceuticals Ltd. in exchange for cash of \$820 and 44,944 common shares of the Company valued at \$200.

The transaction was accounted for by the purchase method, as follows:

<i>Assets</i>	
Cash	\$ 108
Accounts receivable	73
Income taxes recoverable	11
Inventory	108
Fixed assets	17
Goodwill	800
	1,117
<i>Liabilities</i>	
Accounts payable	97
Net assets acquired	\$ 1,020
<i>Consideration</i>	
Cash	\$ 820
Common shares	200
	\$ 1,020

**Notes to the
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In addition, the Company may be required to pay up to an additional \$200 in cash should the net sales of products previously owned by Tican Pharmaceuticals Ltd. exceed a pre-determined threshold over the period July 25, 1996 to January 24, 1998.

Bone Health Inc.

On June 30, 1994 the Company purchased the remaining 2.38% interest in Bone Health Inc. for 175,082 common shares of the Company valued at \$298. The excess of the purchase price over the net assets acquired of \$287 has been charged directly to the deficit. Bone Health Inc. was amalgamated with the Company on June 30, 1994.

3. Accounts Receivable

	1996		1995
Accounts receivable – trade	\$ 1,354		\$ 1,097
Interest and other receivables	881		349
Stēf International Corporation	64		-
Loans to officers	98		40
	<hr/>		<hr/>
	\$ 2,397		\$ 1,486

The advance to Stēf International Corporation is unsecured, interest free and repaid monthly. The loans to officers are non-interest bearing.

4. Long-Term Receivables

	1996		1995
Notes receivable from Deprenyl Animal Health, Inc. (US \$3,090)			
A note of US\$2,500 bears interest at bank prime rate plus 1% per annum, with the balance of the notes bearing interest at 7%. Repayment of the notes commence on July 1, 1997 with quarterly payments of approximately US\$250 (see Note 2).	\$ -		\$ 4,198
Loans to joint venture partner, New IHS, L.L.C., with convertible features			
The loans are maturing, on various dates, 180 days after their provision and interest is computed at US prime plus 1% per annum (see Note 5).	-		338
Promissory notes due from joint venture partner, New IHS, L.L.C.			
The promissory notes are due on demand and interest is computed at US prime plus 1% per annum (see Note 5).	-		345
Advance to an officer			
The advance was made to fund the acquisition of shares of an affiliated company. The loan is non-interest bearing and due on disposition of the shares.	\$ -		\$ 4,992

**Notes to the
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(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

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5. Long-Term Investments

	1996	1995
St�f International Corporation (ownership percentage – 30.8%)		
Investment in common shares (quoted market value – \$1,600)	\$ 958	\$ -
Note receivable	728	-
Equity share of losses	(254)	-
	1,432	-
DUSA Pharmaceuticals, Inc. (ownership percentage 1995 – 12.8%)		
Investment in common shares (quoted market value – 1995 – \$9,792)	- 1,002	1,002
Equity share of losses	- (2,940)	(2,940)
Gain on dilution of investment	- 5,260	5,260
	- 3,322	3,322
Bone Care International, Inc. (quoted market value – 1996 – \$1,176; no quoted market value in 1995) (ownership percentage 1996 – 2.7%; 1995 – 4.5%)	691	609
	\$ 2,123	\$ 3,931

In August 1996, the Company transferred its ownership interest in the joint venture New IHS, L.L.C. ("IHS") to St f International Corporation ("St f"). Prior to the transaction, the Company converted its loans and promissory notes due from IHS to a capital contribution, thereby increasing its ownership interest to 92%. The Company's ownership interest in IHS was then transferred to St f in exchange for 3,000,000 common shares valued at \$1,350 and a note receivable for \$728. The note bears interest at bank prime rate plus 1% per annum and is payable quarterly with principal due on August 6, 2001. All amounts due may be converted at the option of the Company into common shares of St f at \$0.75 per share. Concurrently, the Company purchased from St f's treasury 1,000,000 units for \$500. Each unit consisted of one common share and 0.87 warrants. Each warrant is exercisable for one common share at \$0.75 per share if exercised by July 31, 1998 and at \$1.00 per share if exercised by July 31, 1999.

The Company has recorded its initial investment in St f based on the carrying value of its interest in IHS transferred to St f, plus its investment cost. To December 31, 1996 St f has incurred significant continuing operating losses and negative cash flows. St f's ability to continue operating as a going concern is dependent upon its ability to reduce operating costs, thereby establishing profitable operations and its ability to raise additional equity to finance its operations. If St f is unsuccessful in achieving either of these objectives, the carrying value of the Company's investment in St f may require revaluation in order to reflect the impairment in carrying value.

On March 11, 1996, the Company sold the remaining 1,088,001 shares of common stock of DUSA Pharmaceuticals, Inc. for net proceeds of \$9,323 realizing a gain of \$6,001. Subsequent to the sale, the Company no longer holds an ownership interest in DUSA Pharmaceuticals, Inc.

6. Fixed Assets

	1996	1995
Computer equipment	\$ 602	\$ 505
Laboratory equipment	223	113
Furniture and fixtures	610	357
Leasehold improvements	53	39
	1,488	1,014
Accumulated depreciation and amortization	(751)	(469)
	\$ 737	\$ 545

**Notes to the
Consolidated Financial Statements** *continued*

(December 31, 1996 and 1995)

D R A X I S Health Inc.

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7. Patents, Licenses and Other Deferred Charges

	1996		
	Cost	Accumulated Amortization	Net Book Value
Licenses			
Eldepryl®	\$ 1,330	\$ 794	\$ 536
Permax®	3,500	1,764	1,736
Anipryl®	639	64	575
Patents and trademarks			
DAHI	27,137	220	26,917
Other	90	-	90
Technical assistance	1,800	960	840
	\$ 34,496	\$ 3,802	\$ 30,694

	1995		
	Cost	Accumulated Amortization	Net Book Value
Licenses			
Eldepryl®	\$ 1,330	\$ 717	\$ 613
Permax®	3,500	977	2,523
Anipryl®	-	-	-
Patents and trademarks	62	-	62
Technical assistance	1,800	840	960
	\$ 6,692	\$ 2,534	\$ 4,158

Amortization of patents, licenses and other deferred charges was \$1,268, \$924 and \$517 for the years ended December 31, 1996, 1995 and 1994 respectively.

8. Deferred Income Taxes

Deferred income taxes reflect the net tax effects of timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts applicable for income tax purposes. Significant components of the Company's deferred tax (assets) and liabilities are as follows:

	1996	1995
Gain on dilution of investment in affiliates	\$ -	\$ 2,183
Licenses and other deferred charges	(298)	(359)
Other	(38)	(25)
	\$ (336)	\$ 1,799

9. License Obligation

On February 10, 1994 the Company acquired the Canadian license to market Permax®, a drug for Parkinson's disease. The agreement required the Company to pay \$3,500 for the first five years of the license. The initial payment of \$2,000 was made on signing, \$1,000 was paid February 10, 1995 and \$500 was paid on February 10, 1996.

**Notes to the
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(December 31, 1996 and 1995)

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10. Capital Stock

	1996	1995		
	Number of Shares	Dollars	Number of Shares	Dollars
<i>Common stock</i>				
Balance at beginning of the year	20,126,718	\$ 18,666	20,019,297	\$ 18,393
Issued during the year	9,136,884	34,147	107,421	273
Balance at end of the year	29,263,602	\$ 52,813	20,126,718	\$ 18,666
<i>Issued during the year</i>				
Treasury common share offering	3,000,000	\$ 11,562	-	\$ -
Shares issued on acquisition of				
Deprenyl Animal Health, Inc.	5,729,701	21,486	-	-
Shares issued on acquisition of				
Tican Pharmaceuticals Ltd.	44,944	200	-	-
Exercise of options	349,226	878	101,949	258
Exercise of participation shares	10,046	7	-	-
Shares issued in lieu of salary	2,967	14	5,472	15
	9,136,884	\$ 34,147	107,421	\$ 273

Warrants

Novopharm Limited

On April 19, 1995 the Company issued 500,000 warrants to Novopharm Limited each of which are exercisable to April 18, 2000 to purchase one common share of the Company at \$2.09. The Company issued the warrants to Novopharm Limited in exchange for Novopharm Limited's grant of a six month extension of a profit sharing agreement between the two companies.

In December 1993 the Company formed a strategic alliance with Novopharm Limited. In addition to Novopharm Limited's purchase of 1,176,470 shares from the Company's treasury at an aggregate acquisition price of \$3,000, Novopharm Limited was granted 1,176,470 warrants. Each warrant is exercisable for one common share of the Company for up to four years at a base exercise price of \$2.70, escalating by 10% in each of years three and four.

Underwriters

In connection with the completion of DRAKIS' public offering in April 1996, a non-assignable warrant was issued to the Company's underwriters. The warrant is exercisable for 300,000 DRAKIS shares at \$4.25 per share and expires on April 26, 1998.

Other

In connection with the acquisition of DAHI in November 1996, warrants granted to a scientist by DAHI were exchanged for 270,000 warrants for the purchase of the Company's common shares at US \$2.22 per share. The warrant will become exercisable only if DAHI has net profits, as defined, within seven years of March 14, 1991.

In aggregate, there were 2,246,470, 2,676,470 and 1,176,470 warrants outstanding at December 31, 1996, 1995 and 1994 respectively.

Stock Option Plan

The Board of Directors has adopted a stock option plan in order to provide an incentive for directors, officers and employees. The plan provides that the Board of Directors may, from time to time, at its discretion, grant to directors, officers and employees, the option to purchase common shares. The Board of Directors will determine the price per common share and the number of common shares which may be allotted to each designated director, officer or employee and all other terms and conditions of the option in accordance with the applicable requirements of any relevant regulatory authority or stock exchange. These options will be exercisable for a period not exceeding ten years from the date of the grant.

**Notes to the
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On June 16, 1995, the Board of Directors received shareholder approval to set a maximum of 2,500,000 options for issuance under the stock option plan. On November 25, 1996, in connection with the acquisition of Deprenyl Animal Health, Inc. through a share exchange plan, the Board of Directors received shareholder approval to increase the maximum for issuance under the stock option plan to 4,500,000 options. Subsequent to the completion of the acquisition of Deprenyl Animal Health, Inc., options to acquire shares of Deprenyl Animal Health, Inc. common stock were exchanged for options to acquire shares of the Company's common stock at an exchange ratio of 1.35 to 1.

Changes during the years ended December 31, 1996, 1995 and 1994 were as follows:

	1996	1995	1994
Options outstanding, beginning of year	1,693,500	1,828,000	1,737,202
Options assumed - DAHI	1,554,493	-	-
Options granted	340,000	30,000	183,000
Options exercised	(349,226)	(101,949)	-
Options cancelled or expired unexercised	(111,000)	(62,551)	(92,202)
	<hr/> 3,127,767	<hr/> 1,693,500	<hr/> 1,828,000
Shares exercisable, end of year	2,060,682	1,334,168	1,103,003

Options prices per share:

Exercised during the year	\$1.75 to \$2.55	\$1.75 to \$2.55	-
Granted during the year	\$3.60 to \$4.40	\$2.45 to \$2.63	\$1.70 to \$1.94
Assumed during the year	\$0.33 to \$4.14	-	-

Employee Participation Share Plan

On February 16, 1995, the Company established the Employee Participation Share Plan for the directors, officers and employees of the Company to tie employee compensation more closely to shareholder value. The Employee Participation Share Plan was approved by the shareholders on June 16, 1995. The Board of Directors has provided that it would be a condition to receiving any benefit from the Employee Participation Share Plan that the share price have appreciated at least 25% from the date of issuance of any Participation Shares. The maximum number of Participation Shares issuable pursuant to the Employee Participation Share Plan is 2,000,000.

Vesting takes place over a four year period at the rate of 20%, 20%, 20% and 40% commencing on the first anniversary of the issuance of the Participation Shares and for each of the three years thereafter. Vested Participation Shares are automatically convertible into shares of the Company at the election of the holder, provided that the shares have increased in value since the date of issuance of the vested Participation Shares by the aforementioned 25%. The number of Company shares a Participant will receive when converting Participation Shares is determined by multiplying the number of Participation Shares held by a Participant by a fraction whose numerator is the amount by which the fair market value of a share at the date of conversion exceeds the fair market value of a share as at the date on which the Participation Shares were issued and whose denominator is the fair market value of the shares at the date of conversion.

On February 16, 1995, the Board of Directors of the Company authorized the issuance of 975,000 Series A Participation Shares at a subscription price of \$.30 each. The average of the daily high and low board lot trading prices on each of the five trading days on the Toronto Stock Exchange immediately preceding the issuance of the Series A Participation Shares was \$2.45.

On December 18, 1995, the Board of Directors of the Company authorized the issuance of 555,000 Series B Participation Shares at a subscription price of \$.30 each. The average of the daily high and low board lot trading prices on each of the five trading days on the Toronto Stock Exchange immediately preceding the issuance of the Series B Participation Shares was \$2.25.

The shares have been issued for \$0.30 per share and paid for by the employees through the issuance of a limited recourse promissory note and are secured against the shares.

**Notes to the
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10. Capital Stock *continued from page 33*

Changes during the years ended December 31, 1996 and 1995 were as follows:

	1996	1995
Participation shares outstanding, beginning of year	1,530,000	-
Participation shares granted	-	1,530,000
Participation shares exercised	(23,500)	-
Participation shares cancelled	(187,500)	-
	1,319,000	1,530,000
Participation shares exercisable, end of year	257,000	-

Stock-Based Compensation

United States generally accepted accounting principles require disclosure or recognition of compensation expense related to its stock-based compensation plans. Had compensation cost for stock option plans (including the Employee Participation Share Plan) been determined based upon fair value at the grant date for awards under these plans consistent with the methodology prescribed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", the Company's net income and earnings per share under US GAAP would have been reduced by approximately \$1,434 or \$0.06 per share and \$1,902 or \$0.09 per share in the years 1996 and 1995, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grant in 1996 and 1995; dividend yield of 0%, expected volatility of 55%, risk-free interest rate of 5.5%, and expected lives of an average of five years.

11. Other Income (Expense)

	1996	1995	1994
DUSA Pharmaceuticals, Inc.			
Gain on dilution of investment	\$ -	\$ 1,833	\$ 219
Gain on sale of option	-	3,067	-
Bone Health Inc.			
Loss from operations	-	-	(85)
Severance costs	-	-	(202)
	\$ -	\$ 4,900	\$ (68)

Gain on Dilution of Investment in DUSA Pharmaceuticals, Inc.

On December 14, 1995, DUSA Pharmaceuticals, Inc. completed a public offering for the sale of 3,000,000 shares of its common stock. As a result DRAXIS recorded a gain of \$1,833 on dilution of its investment.

On March 4, 1994, DUSA Pharmaceuticals, Inc. completed a private placement in the United States worth US \$1,200 consisting of 250,000 shares of its common stock at US \$4.80 per share resulting in a gain to the Company of \$219 on dilution of its investment.

**Notes to the
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12. Income Taxes

The following is a reconciliation between the normal Canadian statutory income tax rate and the consolidated effective income tax rate:

	1996	1995	1994
Canadian federal and provincial tax rate	39%	39%	38%
United States federal and state tax rate	34%	34%	-
Income taxes based on the Canadian and US statutory rates	\$ 268	\$ 2,345	\$ 1,875
Tax effect of:			
Capital gains	(945)	(281)	-
Non-deductible portion of amortization of intangible assets	218	104	104
Other permanent differences	141	(104)	(239)
	\$ (318)	\$ 2,064	\$ 1,740

13. Equity Share of Loss of Affiliated Companies

	1996	1995	1994
Equity share of loss of:			
Deprenyl Animal Health, Inc.	\$ (955)	\$ (577)	\$ (1,120)
DUSA Pharmaceuticals, Inc.	-	(956)	(975)
Stef International Corporation	(254)	-	-
	\$ (1,209)	\$ (1,533)	\$ (2,095)

During 1995, the Company's investment in Deprenyl Animal Health, Inc. was reduced to zero as a result of recording its equity share of losses. The portion of unrecognized loss that would otherwise have been recorded at December 31, 1995 was \$685.

In June 1996, shareholders of DAHI approved the conversion feature of a US \$1,000 advance made by the Company to DAHI in January 1996 and the Company clarified its commitment with respect to the future financing requirements of DAHI. As a result, in the second quarter of 1996, the Company recorded its share of DAHI's loss of \$685, which had not been previously recognized for accounting purposes.

14. Earnings per Share

Earnings per share is based on the weighted average number of common shares outstanding (basic) adjusted, to the extent they are dilutive, for outstanding stock options and stock purchase warrants (fully diluted). Basic earnings per share and fully diluted earnings per share are not materially different for the years presented.

15. Related Party Transactions

Significant transactions not otherwise disclosed in the accompanying financial statements, were as follows:

	1996	1995	1994
Sales of dermatological products to a significantly influenced investee included in sales	\$ 30	\$ -	\$ -
Net contribution from the sales of a product by a company which is a shareholder included in income from operations (total revenues 1996 - \$7,120; 1995 - \$5,942; 1994 - \$2,494)	\$ 2,063	\$ 2,513	\$ 2,326

**Notes to the
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15. Related Party Transactions (continued from page 35)

	1996	1995	1994
Recovery of salaries expense for services provided to significantly influenced investees for administrative, financial, scientific, and marketing support included in selling, general and administration expense	\$ 39	\$ 87	\$ 95
Research and development expenditures incurred and recovered from a significantly influenced investee included in research and development expense and research and development recovered from an affiliated company	\$ 34	\$ 381	\$ 534
Rent paid to a company jointly controlled by a member of the Board of Directors included in selling, general and administration expenses	\$ 146	\$ 144	\$ 128
Interest received from a significantly controlled investee, prior to acquisition, included in interest income	\$ 254	\$ 334	\$ 253
Interest received from a joint venture, New IHS, L.L.C., included in interest income	\$ -	\$ 40	\$ -

The aforementioned transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Summarized earnings statement and balance sheet of the Company's proportionate combined interest in New IHS, L.L.C. is as follows:

	1996	1995
Proportionate statement of operations		
Sales	\$ 366	\$ 598
Expenses	677	1,178
Net loss	\$ (311)	\$ (580)
Proportionate balance sheet		
Current assets	\$ -	\$ 205
Long-term assets	-	19
Current liabilities	-	(122)
Long-term liabilities	-	(682)
Capital stock	-	-
Deficit	\$ -	\$ (580)
Proportionate statement of cash flows		
Cash flows from operating activities	\$ (236)	\$ (655)
Cash flows from investing activities	910	(19)
Cash flows from financing activities	(682)	682
Net (decrease) increase in cash	(8)	8
Cash at beginning of period	8	-
Cash at end of period	\$ -	\$ 8

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16. Commitments

In connection with the acquisition of DAHI on November 27, 1996, and subject to good business judgement, the Company intends to commit approximately US\$10,000 to DAHI to complete the process of obtaining approval from the United States Food and Drug Administration for Anipryl®, to launch Anipryl® in the United States and to acquire and develop new veterinary products.

On January 31, 1995, the Company acquired from Somerset Pharmaceuticals Inc. the exclusive Canadian marketing rights to the osteoporosis drug Ipriflavone. The Company paid US \$100 upon signing of the agreement and will be required to make payments of US \$200 at the time Somerset Pharmaceuticals Inc. files a New Drug Submission with the Health Protection Branch, Health and Welfare Canada and US \$400 upon issuance of a Notice of compliance on that New Drug Submission by the Health Protection Branch, Health and Welfare Canada. In addition, the Company agreed that in the event that during the twelve months prior to the third anniversary of the launch of Ipriflavone, gross sales of Ipriflavone exceed \$10,000 the Company would pay to Somerset Pharmaceuticals Inc. an additional amount equal to seven percent of all gross sales above \$10,000 during such twelve-month period.

During November 1992, the Company entered into a license agreement with Laboratoire L. Lafon for the right to market any product containing the compound Modafinil in Canada. The cost of the license consisted of a cash payment of US \$150 and the Company paid an additional US \$150 upon filing a New Drug Submission in June 1993. The Company will be required to make a further cash payment of US \$300 upon receiving Health Protection Branch, Health and Welfare Canada approval to market such products.

The Company may be required to pay an additional \$786 should the gross revenues of Lipopharm division (amalgamated July 30, 1993) exceed certain amounts in any fiscal year through December 31, 1997. Such payments, if any, would be satisfied through the issuance of common shares of the Company based upon the average price of the common shares of the Company for the fifteen days preceding the end of the month in which the gross revenue targets were exceeded.

On October 1, 1990 and subsequently amended on July 5, 1995, DAHI entered into an exclusive supply agreement with Chinoïn Pharmaceutical and Chemical Works Company Ltd. ("Chinoïn") whereby Chinoïn has agreed to manufacture and supply the Company's requirements for l-deprenyl in North America. The agreement provides that DAHI will purchase the product from Chinoïn for a period of four years, beginning on the effective date of the amendment. In addition, DAHI must pay a royalty of three percent to Chinoïn on net sales of Anipryl® for a three year period. DAHI has developed the data required to qualify an alternative source of supply for l-selegiline. The agreement ends on the earliest of (i) November 22, 2003, or any extended expiration date agreed to by Chinoïn and the United States licensee under a license agreement between them, or (ii) a determination date pursuant to provisions regarding force majeure or certain other events.

Pursuant to a consulting agreement, DAHI has agreed to pay a scientist 3.5% of the net profits of DAHI from the sale of animal products containing l-deprenyl pursuant to the grant of certain patent rights. DAHI has no intention to develop the products related to these patent rights.

The Company is committed under operating leases for buildings requiring minimum annual lease payments of \$210, \$173 and \$56 for 1997, 1998 and 1999, respectively.

17. Financial Instruments

The fair value of cash, accounts receivable, accounts payable and accrued charges are equivalent to their carrying value because of the short-term maturity of those instruments. The fair value of long-term investments is determined based on quoted market prices. The Company is not party to any significant derivative instruments.

The Company is subject to credit risk through trade receivables, note receivable included in long-term investments and short-term cash investments. Credit risk with respect to trade receivables is limited given the creditworthiness of the counterparties. Exposure to credit risk associated with the note receivable is determined by reviewing the fair value of the Company's total investment, which includes the carrying value of the note receivable. The Company places its temporary excess cash investments in high quality government securities and short-term commercial paper.

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18. Segmented Information

Geographic Segmentation

	1996	1995
Sales		
Canada	\$ 13,198	\$ 14,836
United States	902	598
	\$ 14,100	\$ 15,434
 (Loss) income from operations		
Canada	\$ (2,264)	\$ 2,108
United States	(3,122)	(1,543)
	\$ (5,386)	\$ 565
 Identifiable assets		
Canada	\$ 38,176	\$ 34,770
United States	29,363	282
	\$ 67,539	\$ 35,052

In 1994, all of the Company's identifiable assets, sales and income from operations were derived from its Canadian operations.

19. Subsequent Events

In January 1997, the Company entered into a supply and distribution agreement with Mylan Laboratories Inc. ("Mylan") for the exclusive Canadian rights to market the Mylan formulation of the cancer drug, Paclitaxel. The agreement provides for the sharing of profits from the marketing and selling of Paclitaxel in Canada according to a formula agreed to between the parties. The agreement is for an initial term of five years from the date of product approval by the Health Protection Branch with automatic one-year renewals at the option of both parties.

On February 14, 1997, the Company acquired all of the outstanding shares of SpectroPharm Inc. for cash of \$9,000 plus an amount equal to the fair market value of current assets less current liabilities. Concurrent with the acquisition, the Company entered into a non-competition agreement with the vendors. In consideration for the agreement, the Company will make payments based on a percentage of non-Canadian sales from products in existence at the time of acquisition.

**Notes to the
Consolidated Financial Statements** *continued*
(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

*(in thousands of Canadian dollars
except share related data)*

20. Cash Flows from Operating Activities

	1996	1995	1994
Net (loss) income for the year	\$ (166)	\$ 2,417	\$ 1,099
Non-cash transactions reflected in net (loss) income			
Depreciation and amortization	1,428	1,051	632
Amortization of goodwill	267	234	234
Deferred income taxes	(1,439)	729	110
Equity share of net loss of affiliated companies	1,209	1,533	2,096
Gain on sale of shares in DUSA Pharmaceuticals, Inc.	(6,001)	-	-
Gain on sale of option in DUSA Pharmaceuticals, Inc.	-	(3,067)	-
Gain on dilution of investment in DUSA Pharmaceuticals, Inc.	-	(1,833)	(219)
Gain on sale of securities	(110)	(549)	(59)
	(4,812)	515	3,893
Changes in current assets and current liabilities impacting cash flows from operations			
Accounts receivable	(838)	321	1,253
Inventory	(704)	310	(412)
Proceeds from sale of marketable securities	109	1,316	2,104
Prepaid expenses	363	150	(305)
Accounts payables and accrued charges	(374)	(237)	(68)
Royalties payable	261	(193)	(64)
Income taxes	(695)	85	(106)
	(1,878)	1,752	2,402
Cash flows (used in) from operating activities	\$ (6,690)	\$ 2,267	\$ 6,295
Non-cash transactions			
Common shares of the Company issued in exchange for shares of Bone Health Inc.	\$ -	\$ -	\$ 298
	\$ -	\$ -	\$ 298

**Notes to the
Consolidated Financial Statements** *continued*

(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

(in thousands of Canadian dollars
except share related data)

21. United States Generally Accepted Accounting Principles

The consolidated financial statements have been prepared in accordance with Canadian GAAP which conforms, in all material respects applicable to the Company, with US GAAP during the years presented except for the following:

	1996	1995	1994
Consolidated net income (loss)			
As reported under Canadian GAAP	\$ (166)	\$ 2,417	\$ 1,099
Adjustments to reported consolidated net income (loss)			
Amortization of technical assistance costs	968 120	120	120
Increase in <u>gain on sale of shares</u> in affiliated company under US GAAP	1124 3,930	-	-
Amortization of patents and trademarks	34 220	-	-
(Increase) reduction in income tax expense due to differences in net income from Canadian to US GAAP reconciling items	(10)(1,165)	1,334	20
Elimination of patents and trademarks	(34)(29,406)	-	-
Reversal of deferred taxes	(42)(697)	-	-
Elimination of <u>gain on dilution of investment</u> in affiliated companies	-	(1,833)	(219)
Elimination of gain on sale of option in affiliated company	-	(3,067)	-
	(26,998)	(3,446)	(79)
As adjusted under US GAAP	\$ (27,164)	\$ (1,029)	\$ 1,020
(Loss) earnings per share – US GAAP	\$ (1.09)	\$ (0.05)	\$ 0.05
Average common shares and common share equivalents – US GAAP	24,984,139	21,270,112	19,927,427

Earnings Per Share

Under Canadian GAAP, basic earnings per share is computed using the weighted average number of shares outstanding during the year. Under US GAAP, the weighted average number of shares is computed including dilutive options and warrants and as if the funds obtained from the assumed exercise of options were used to purchase common shares at the average market price during the period.

Patents, Licenses and Other Deferred Charges

Amortization of technical assistance costs are payments made to a third-party licensor for technical assistance to be provided to the Company for product development, market penetration and clinical testing of new products.

Under Canadian GAAP, these costs are deferred and charged to expense on a straight-line basis beginning in 1989.

Under US GAAP, these costs are charged to expense as incurred. During 1988 such costs were charged to expense for US GAAP purposes. Commencing in 1989, amortization of these costs for Canadian GAAP has been added back to pre-tax income for US GAAP reconciliation purposes.

Under Canadian GAAP, the acquisition of DAHI (see Note 2) was accounted for by the purchase method of accounting. The cost of the purchase and amounts assigned to assets acquired and liabilities assumed were determined as of the date of acquisition. The excess of the purchase price over the fair value of the assets acquired of \$29,406 (\$26,468 – Canadian GAAP) was allocated to patents and trademarks.

**Notes to the
Consolidated Financial Statements** *continued*

(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

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Under US GAAP, the acquisition would also have been accounted for by the purchase method, however, the cost of the purchase would be calculated at the date of the share exchange agreement. The effect of this difference is that the amount assigned to the patent and trademark for US GAAP is \$29,406. At the date of acquisition, the patented and trademark license had yet to receive regulatory approval for its significant indications and markets. Accordingly, the amount has been charged to expenses.

X Gain on Dilution of Investments in Affiliated Companies

Under Canadian GAAP, an offering that takes the form of an investee's direct sale of its unissued shares, in an amount in excess of the investor's carrying value, is reflected as a gain on dilution in the investor's statement of operations.

Under US GAAP, the additional equity raised by an investee in the development stage is reflected as an equity transaction in the investor's statement of shareholders' equity.

Gain on Sale of DUSA Option in Affiliated Companies

Under Canadian GAAP, a gain is recognized for the excess of proceeds over the carrying value of the option.

Under US GAAP, a gain on sale of the option reduces the carrying value of the Company's remaining investment in common stock of DUSA, since DUSA is considered to be in the development stage.

Unrealized Investment Gains and Losses

Due to the acquisition of DAHI, the Company reviewed its investment strategy and as a result its investments were reclassified from "held to maturity" to "available for sale." Statement of Financial Accounting Standards ("SFAS") No. 115 requires the Company to record securities which management has classified as available for sale at fair market value and to record unrealized gains and losses on securities available for sale as a separate component of shareholders' equity until realized. As at December 31, 1996, securities available for sale amounted to \$24,145 and the unrealized gains of \$640 would be recognized within shareholders' equity. For Canadian GAAP, investments are recorded at cost and gains and losses are recognized when realized.

Securities available for sale consist of Canadian treasury bills and commercial paper with yields ranging from 2.9% to 5.5% and maturity dates ranging from January 6, 1997 to August 20, 1997.

Deferred Taxes

Prior to the acquisition of DAHI, the Company established net deferred tax liabilities related to the dilution of its investment in the acquiree. As the Company has acquired DAHI this liability no longer exists. For Canadian GAAP, the reversal of the deferred taxes has been credited against the share of the equity losses from DAHI. For US GAAP, gains on dilution of investments were reflected as an equity transaction and the reversal of deferred taxes has been recorded similarly.

< 231927> Shareholders' Equity

Shareholders' equity determined under US GAAP as at December 31, 1996, 1995, and 1994, would (decrease) increase by \$21,453 \$770 and \$1,090 respectively, compared to the amounts determined under Canadian GAAP.

< 21453> Statement of Changes in Cash Flows

	1996	1995	1994
Net increase (decrease) in cash and cash equivalents under Canadian GAAP	\$ 9,222	\$ 4,915	\$ (514)
Net decrease in cash and cash equivalents (see note below)	(8,466)	(5,102)	(9,937)
Net increase (decrease) in cash under US GAAP	756	(187)	(10,451)
Cash and cash equivalents at beginning of the year	1,567	1,754	12,205
Cash and cash equivalents at end of the year	\$ 2,323	\$ 1,567	\$ 1,754

Treasury bills and commercial paper are considered cash equivalents for Canadian GAAP purposes. For US GAAP purposes only treasury bills and commercial paper with original maturities of three months or less are considered cash equivalents.

Income taxes paid for the years' ended December 31, 1996, 1995, and 1994 are \$1,828, \$1,250 and \$3,410 respectively.

**Notes to the
Consolidated Financial Statements** *continued*

(December 31, 1996 and 1995)

D R A X I S H e a l t h I n c.

(in thousands of Canadian dollars
except share related data)

	1996
STËF INTERNATIONAL CORPORATION	
Current assets	\$ 488
Intangible assets	\$ 811
Total assets	\$ 1,409
Current liabilities	\$ 516
Total liabilities	\$ 1,452
Shareholders' deficiency	\$ (43)
Percentage ownership of common shares held by the Company	30.8%
Quoted market value of investment	\$ 1,600
Sales	\$ 2,438
Gross margin	\$ 1,760
Net loss	\$ (1,076)

	1995
DEPRENYL ANIMAL HEALTH, INC.	
Current assets	\$ 1,442
Total assets	\$ 2,129
Current liabilities	\$ 186
Total liabilities	\$ 4,402
Total shareholders' equity	\$ (2,273)
Percentage ownership of common shares held by the Company	35.7%
Quoted market value of investment	\$ 4,977

	1995	1994
Interest and other income	\$ 385	\$ 288
Research and development expenses	\$ 1,921	\$ 1,732
Net loss	\$ 2,581	\$ 3,498

	1995
DUSA PHARMACEUTICALS, INC.	
Current assets	\$ 28,348
Total assets	\$ 28,419
Current liabilities	\$ 830
Total liabilities	\$ 830
Total shareholders' equity	\$ 27,589
Percentage ownership of common shares held by the Company	12.8%
Quoted market value of investment	\$ 9,792

	1995	1994
Interest income	\$ 795	\$ 969
Research and development expenses	\$ 4,180	\$ 3,769
Net loss	\$ 4,095	\$ 4,838

Officers and Directors

Brian M. King¹
Director and Chairman

James P. Doherty²
*Director and Vice
Chairman*

Martin Barkin, MD,
BScMed, MA, FRCSC
*Director, President,
CEO, COO*

Leslie L. Dan²
Director

George Darnell
Director

Samuel Sarick^{1,2}
Director

Stewart D. Saxe¹
Director

Jim A. H. Garner
*Vice President Finance
and Chief Financial Officer*

Jacqueline H. R. Le Saux,
MBA, LL.B
*Vice President,
Corporate Development,
and Secretary,
Business Unit Leader:
Canadian Pharmaceutical
Marketing Operations*

Roger Mailhot, PhD
*Vice President, Scientific
and Regulatory Affairs*

Bernard J. Marzalik
*Vice President,
Marketing and Sales,
Business Unit Leader:
Dermatology Operations*

Shareholder Information

Annual Meeting

The annual meeting of shareholders will be held at The Sheraton Centre Toronto Hotel, 123 Queen Street West, Toronto, Ontario commencing at 8:30 a.m. on Tuesday July 8, 1997. Formal notice of the meeting together with the proxy statement and a form of proxy will be mailed to each registered owner of common shares.

Form 20-F

For regulatory purposes in the United States, the Company files an Annual Report with the Securities and Exchange Commission. A copy may be obtained by any shareholder upon request to the Company.

Stock Listings

DRAKIS Health Inc. common shares are listed in Canada on The Toronto Stock Exchange (TSE) and in the United States on the National Association of Securities Dealers and Quotations Inc. (NASDAQ).

In 1996 share trading volume on the TSE was 11,307,466 shares or an average of 44,694 shares per trading day.

In 1996 share trading volume on NASDAQ was 32,112,710 shares or an average of 125,932 shares per trading day.

Transfer Agent and Registrar

*Montreal Trust Company of Canada
Corporate Services Division
Stock and Bond Transfer Services
151 Front Street West, 8th Floor
Toronto, Ontario M5J 2N1
(416) 981-9500 telephone
(416) 981-9800 fax*

Shareholder Services

*Please direct inquiries to the attention of:
Investor Relations
DRAKIS Health Inc.
6870 Goreway Drive
Mississauga, Ontario L4V 1P1
(905) 677-5500 telephone
(905) 677-5502 fax
Internet: www.draxis.com*

*Corporate Counsel
McCarthy Tétrault
Toronto, Ontario*

*Auditors
Deloitte & Touche
Toronto, Ontario*



DRAKIS Health Inc.

6870 Goreway Drive, Mississauga, Ontario, Canada L4V 1P1